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Convener
Scottish Parliament
Economy, Jobs and Fair Work Committee
Scottish Parliament Building
Edinburgh
EH99 1SP

2nd August

Dear Convener,

INQUIRY INTO THE PERFORMANCE OF THE SCOTTISH ECONOMY

At Mr Brown's Committee appearance on 22 May he undertook to provide further information on two matters and this letter covers these issues. It also addresses an earlier issue from the inquiry into economic statistics.

Firstly Mr Brown offered to share his recent correspondence with Liam Fox in relation to protected geographical indicators. Annex A provides a copy of that correspondence.

Secondly Mr Brown offered to provide an update from on the Road Equivalent Tariff (RET). The 2016 manifesto contained a commitment to "take action to reduce fares on ferry services to Orkney and Shetland". In August 2017 the then Minister for Transport and the Islands, Humza Yousaf MSP, announced the intention to introduce reduce passenger and car fares within the first half of 2018.

The intention was that Road Equivalent Tariff (RET), as applied on Clyde and Hebrides ferry services, would be introduced on the Scrabster – Stromness route. An RET variant, which was adapted to take account of the longer distances, would be rolled out on the Aberdeen – Kirkwall, Aberdeen – Lerwick and Kirkwall – Lerwick routes.

Introduction of reduced fares for the Northern Isles is much more complex than it was for the Clyde and Hebrides.

As a first step, as of 30 June passenger and car fares on routes to Shetland (Aberdeen-Lerwick and Kirkwall-Lerwick services) have been reduced by 20%.

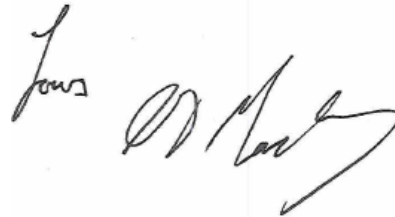
On routes to Orkney, it has been necessary to engage with commercial operators on the Pentland Firth and develop a scheme that included them in order to ensure compliance with relevant state aid and competition rules. Unfortunately, not all the commercial operators

have felt able to agree to our proposals. This means we cannot currently implement reduced fares on any of the routes to and from Orkney without the risk of legal challenge.

This is both disappointing and frustrating, but we are determined to work through the issue to see what more can be done. Transport Scotland will undertake some further work to see what measures, if any, can be taken. As part of that, we are willing to reopen talks with commercial operators with a view to bringing the full benefits of the scheme to the people of Orkney and Shetland.

Finally as part of the inquiry into economic statistics Mr Brown offered to provide information about the likely scale of the illegal economy. Annex B provides information on this.

I hope you find this helpful and would be happy to discuss further as required.

A handwritten signature in black ink, appearing to read 'Derek Mackay', written over a light blue grid background.

DEREK MACKAY

Cabinet Secretary for Economy, Jobs and Fair Work
Keith Brown MSP



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Rt Hon Liam Fox MP
Secretary of State for International Trade
Department for International Trade
King Charles Street
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21 March 2018

I read with increasing concern of the steps being taken by the United States administration to impose import tariffs on steel and aluminium, and that the European Commission may retaliate with a package of measures targeting iconic US products.

Obviously, in Scotland we have a very direct interest in both steel and aluminium and I am aware that your department has done some preliminary work around the potential impact of the US proposals on these sectors. However, it would be helpful to know what wider analysis your Department has made of the US and Commission proposals, and their impact on the UK. At a time when businesses such as Airbus are expressing concern about the potential impact of border and Customs processes on their operations post-Brexit, they could do without further uncertainty being created in relation to key materials.

We are concerned that this escalates into a “tit-for-tat” approach, with the US targeting iconic EU products. We only need to look back to the Banana Wars of the early 2000s to see a case where a dispute about one type of goods turned quickly into retaliatory measures on cashmere, to the detriment of Scottish producers. As the Commission has proposed to target bourbon, then the potential for retaliatory US measures on Scotch Whisky must be considerable. Scotch Whisky exports to the US were worth £922m last year, with US and EU spirits producers having enjoyed duty-free access to each others’ markets for 2 decades. Damage to that trade is of great concern to me and to the Scotch Whisky industry, as I am sure it is to you. Your Department is also embarking on the establishment of a UK-US replacement for the EU-US Spirit Drinks Agreement, which provides for mutual recognition and protection of spirit drinks designations. Given the noises from some US commentators against what they see as a form of protectionism, this work will be made more difficult if key products are embroiled in a trade war.

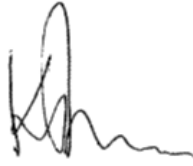
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St Andrew’s House, Regent Road, Edinburgh EH1 3DG
www.gov.scot



What stance is the UK Government taking in its engagement with the European Commission on this issue?

I am copying this letter to the Secretary of State for Scotland.



KEITH BROWN

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ANNEX B NATIONAL ACCOUNTS FOR SCOTLAND – MEASURING THE ILLEGAL ECONOMY

By its nature, it is hard to measure the illegal economy as there are little data available. Two aspects of this are considered in this note: illegal trade; and illegal production and consumption activities.

Illegal trade

It is a Eurostat requirement for Gross National Income and Balance of Trade estimates that illegal trade is included. This ensures international comparability.

At the UK level, the Office for National Statistics (ONS) produces UK estimates for trade in illegal drugs, imports of illegal tobacco (smuggling) and imports of illegal alcohol (smuggling) for inclusion in the balance of payments estimates.

For Scotland, our main sources of trade figures come from the Global Connections Survey, HMRC data for trade in goods, and ONS data for trade in services. These sources do not include estimates for illegal trade or smuggling. These activities are therefore excluded from our published trade statistics. In the Supply-Use balances, however, which lie at the heart of Scotland's national accounts, estimates for imported drugs etc. are addressed in the balancing process to ensure consistency with the UK national accounts.

Inclusion of illegal drug and prostitution activities in the National Accounts

The European System of Accounts (ESA 1995) states that illegal activities fall within the production boundary of national accounts. In response to this requirement, the Office for National Statistics (ONS) has included these in the UK national accounts since the Blue Book in 2014 – see footnote¹ for further details. In 2010, these were estimated to be around 0.24% of total GDP for drugs and 0.35% of GDP for prostitution.

To ensure consistency with the UK national accounts, the Scottish Government included estimates of these activities at the same time. A UK population-based share was included in the Scottish Supply-Use tables. Estimates of household consumption on prostitution in Scotland is based on a male population 16 and over share of UK estimated expenditure. For output measures, the Scottish GVA estimates are largely constrained to the ONS's Regional GVA estimates, and therefore implicitly include estimates of illegal production.

Office of the Chief Economic Adviser
June 2018

¹ <http://webarchive.nationalarchives.gov.uk/20160107230701/http://www.ons.gov.uk/ons/rel/naa1-rd/national-accounts-articles/inclusion-of-illegal-drugs-and-prostitution-in-the-uk-national-accounts/index.html>